



Transatlantic Divergences in Globalisation and the China Factor

Jeanne Metivier, Mattia Di Salvo
and Jacques Pelkmans

Summary

The EU and the United States are following divergent paths with regard to their respective trade policies. While the new administration of the United States has made some notably strong statements against further trade liberalisation, the EU continues to favour responsible globalisation. The EU has recently signed a series of free trade agreements (FTAs) as well as plurilateral agreements with its partners (especially, but not only, in East Asia). Consequently, the EU is strengthening its status as a global leader in the debate on economic openness. Conversely, the US has interrupted major negotiations with its trading partners and has renounced trade agreements, such as TPP and TTIP (at least for the time being). This paper provides some empirical economic and social guidance behind the recent policy divergence on globalisation between the US and the EU in general and vis-à-vis China in particular.

Jeanne Metivier is Associate Researcher, Mattia Di Salvo is Research Assistant and Jacques Pelkmans is Senior Research Fellow at CEPS.

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Introduction

Between the US and the EU, recent policy attitudes vis-à-vis globalisation have begun to diverge starkly. The contrast in views may well be rooted in divergences in their respective globalisation performances and in the socio-economic impact on (some) workers in the US and the EU. We show, based on empirical indicators, that the US has been less successful in recent globalisation than the EU. Moreover, the relatively more flexible labour market in the US has insufficiently compensated workers for the negative short-term effects of global competition in goods markets, and the US trade adjustment and social systems have traditionally been relatively weak in recompensing the ‘losers’ even temporarily. In the EU, on the whole, negatively affected workers tend to be more systematically protected. We also show that the contrast in globalisation performance between the US and the EU holds true even more in the case of bilateral trade and investment relations with China.

The structure of this CEPS Policy Insight is as follows. Section 1 sets out the comparative globalisation performance between the US and the EU. Subsections deal with the trade perspective, their ‘regional globalisation’ in Eastern Europe and within NAFTA, respectively, and the nexus between offshoring, FDI and jobs. Section 2 discusses the protection of (US and EU) workers suffering from job displacement due to globalisation, both in the narrow sense of trade adjustment assistance and in a wider sense by means of the welfare state. Section 3 asks whether globalisation worsens income distribution and whether this is different between the US and the EU. Section 4 offers conclusions on the empirical evidence and links it briefly to divergent policy attitudes on both sides of the Atlantic on globalisation in general and vis-à-vis China in particular.

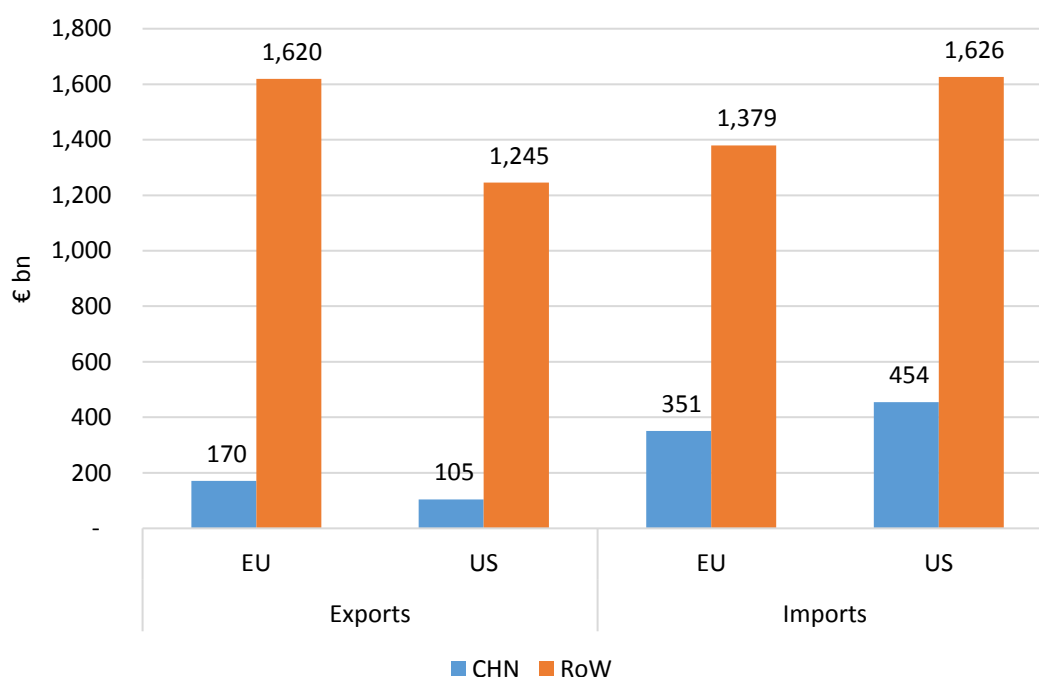
1. Diverging EU-US globalisation performance

Globalisation is a general term. When focusing on well-accepted key elements of it, however, such as trade in goods and the domestic value-added incorporated, the performance in regional integration encompassing higher- and lower-wage countries (so-called regional globalisation, here, respectively in Eastern Europe and in NAFTA) and the link between offshoring (FDI) and jobs at home, it can be shown that the EU’s globalisation performance is significantly better than that of the US.

1.1 On trade and incorporated domestic value-added

Recent trends and data show that the United States and the European Union have been ‘globalising’ in distinctly different ways. The value of extra-EU exports of goods to the world is much higher than that of the US (Figure 1). In particular, extra-EU exports to China (€170 billion) exceed those of the US to China (€104 billion) by a significant margin. On the imports side, global extra-EU imports in goods have been decreasing since 2012, whereas global US imports in goods have continued to increase. As a result, the overall US trade deficit in goods grew further, while the EU observes a global trade surplus in goods since the end of 2012. The US trade deficit appears as a major concern for the new US administration and may greatly influence future US trade policy, notably towards China. Indeed, although both economies have a large deficit with China (in goods), the EU deficit is a ‘mere’ 30% of China’s bilateral exports, whereas the US deficit amounts to no less than 60% of China’s bilateral exports to the US.

Figure 1. EU and US trade with China and with the rest of the world in 2015 (€ bn)



Note: US values of exports and imports have been converted into euro using average yearly exchange rates from the ECB.

Source: Authors’ own elaboration based on Eurostat, UNCOMTRADE and ECB.

Another way to (broadly) assess relative competitiveness vis-à-vis China is to study the revealed comparative advantage (RCA)¹ in specific sensitive sectors. A country enjoys an RCA in a specific

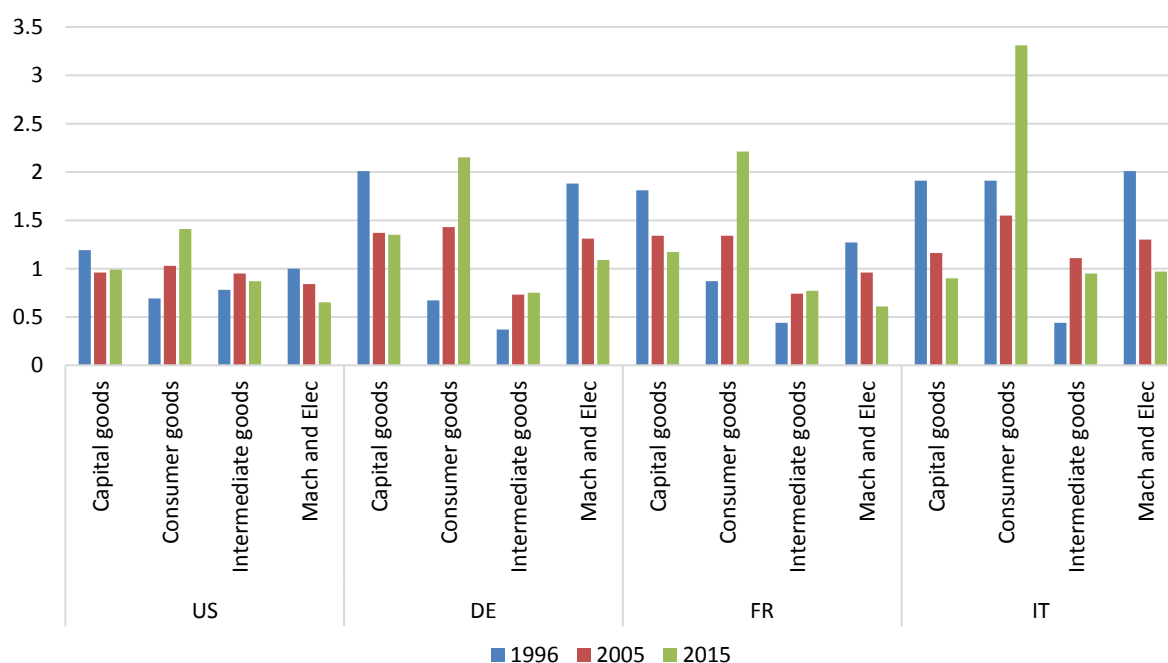
¹ Revealed comparative advantage is measured by the RCA index = $\left(\frac{E_{ij}}{E_{it}} \right) / \left(\frac{E_{nj}}{E_{nt}} \right)$; where i is the country index, n is the set of countries, j is the commodity index, and t is the set of commodities. Note that an RCA takes the existing structure of protection for granted, even though it might yield biases.

sector (either vis-à-vis the world or a given trading partner) when the index is higher than one. Figure 2 plots RCAs for China vis-à-vis the US, Germany, France and Italy in the capital goods, consumer goods, intermediate goods and machinery and electrical sectors. RCA indexes for each of these sectors show similar trends over time for all four countries analysed. Whereas RCAs in consumer and intermediate goods increased between 1996 and 2015, those of capital goods and machinery and electrical decreased.

Nonetheless, values and changes across time significantly differ for the countries analysed. Looking at the US first, the country enjoyed an RCA vis-à-vis China in capital goods as well as in machinery and electrical back in 1996 (with a value of 1.19 and 1, respectively), and in consumer goods both in 2005 and 2015 (with a value of 1.03 and 1.41, respectively). The three European countries show higher RCAs compared to the US in all the sectors, except for intermediate goods. This is especially true for consumer goods, as Germany, France and Italy saw their RCA significantly grow between 1996 and 2015, reaching values above 2 (or even above 3 for Italy), while the US is lagging behind at a value of 1.41.

Although Figure 2 presents a very broad analysis of relative competitiveness in exports toward China, it provides clear evidence of the better performance vis-à-vis China by three big EU countries' exporters compared to the US.

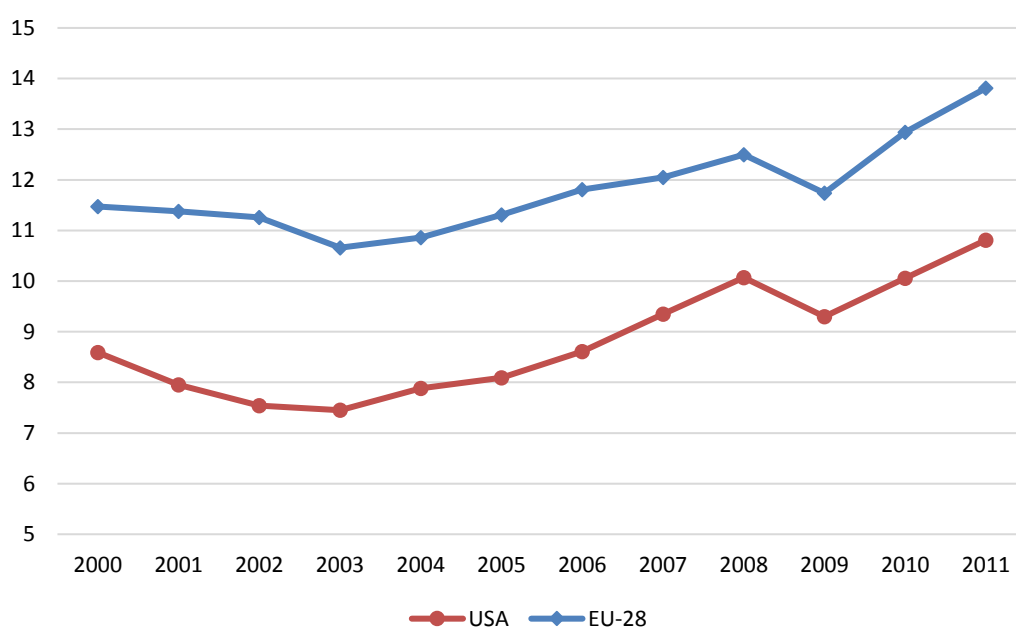
Figure 2. Evolution of revealed comparative advantage vis-à-vis China for the US, Germany, France and Italy in significant sectors



Source: WITS database (WB).

Moreover, domestic industries in EU member states supply more value-added incorporated in goods to other countries than do domestic industries in the United States. Therefore, the impact of final foreign demand on domestic output is greater in EU member states than it is in the United States (Figure 3). That is, this key element of globalisation generates more prosperity and jobs in the EU than in the US.

Figure 3. Share of domestic value added embodied in foreign final demand (extra-EU trade) (%)



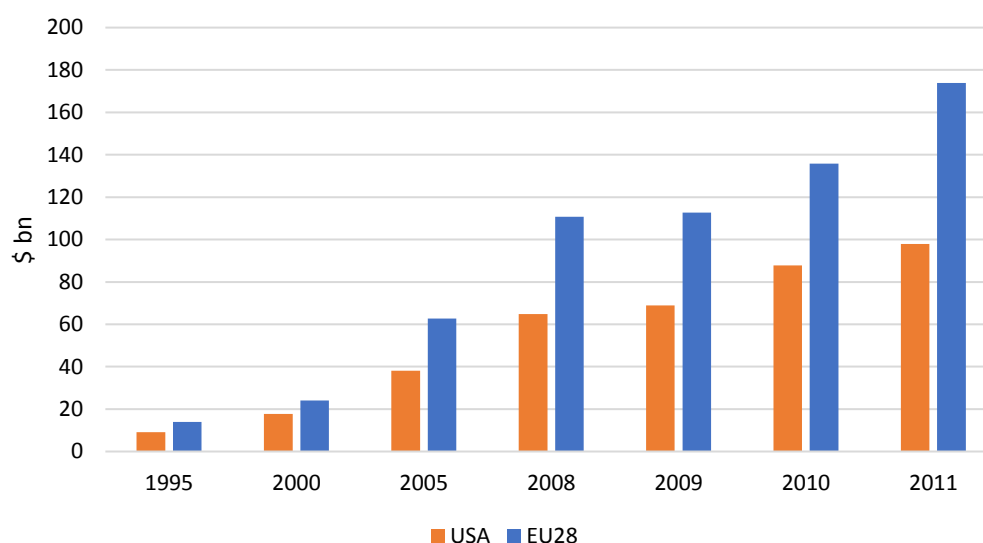
Source: Authors' own elaboration based on Trade in Value Added, TiVA (OECD).

In particular, the EU value added incorporated in goods demanded by China is much higher than that of the United States. Domestic value added by EU industries embodied in China's final demand has been increasing since 1995, and represented almost twice that of the United States in 2011 (Figure 4).

This marked difference may be linked to the relatively stronger RCAs that the EU enjoys in exports to China compared to the US (as shown above in Figure 2). The considerable RCA in consumer goods might have particularly enhanced European domestic production targeted at serving Chinese demand.

Furthermore, looking at foreign-value added embodied in Chinese exports in 2011, the EU accounted for \$107 billion of Chinese exports' value added compared to \$59 billion generated in the US. Within the total foreign-value added embodied in Chinese exports, \$40 billion (for the EU) and \$25 billion (for the US) were linked to the manufacturing industry. In other words, EU trade in goods with China has generated stronger growth than has US trade with China.

Figure 4. EU and US domestic value added embodied in China's final demand (\$ bn)



Source: Authors' own elaboration based on Trade in Value Added, TiVA (OECD).

1.2 Comparing EU and US 'regional' globalisation

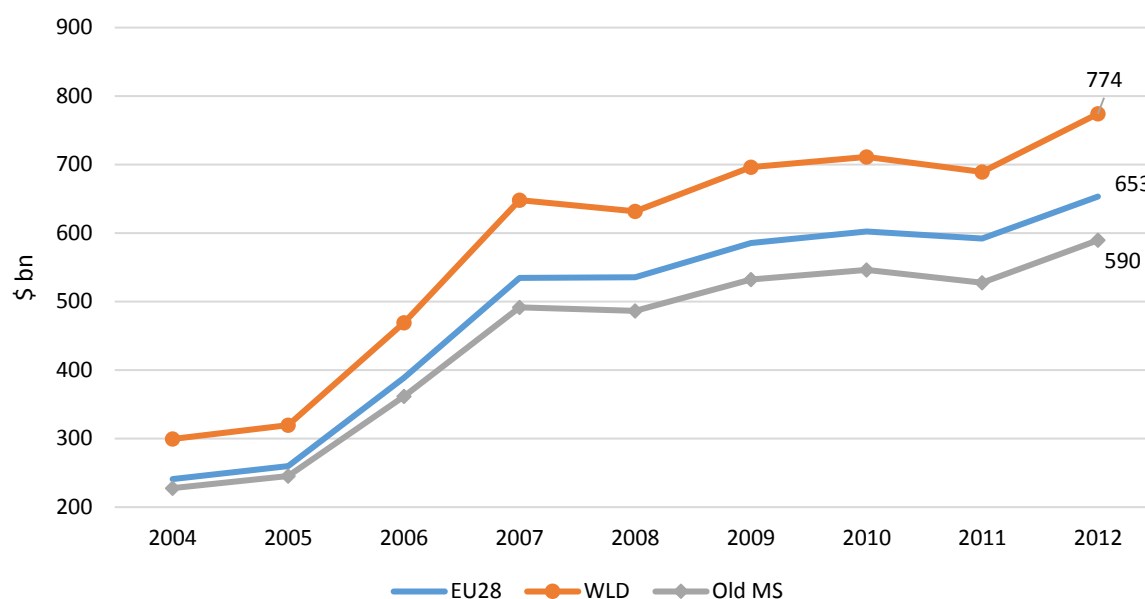
In the 1990s, both the US and the EU-15 initiated forms of regional market integration with regional value chains, which could, to some degree, substitute for (or indeed pre-empt) globalisation with far-away countries: NAFTA and the Eastern enlargement of the EU. Both forms pursued far-reaching goods market integration combined with FDI. However, regional globalisation in the US has drawn substantial criticism, in particular with regard to the labour market (exports of jobs due to relocation to Mexico). On the contrary, EU regional integration intensified trade relationships and boosted FDI between West and East European countries, but – on the whole – this did not occur at the expense of workers.²

If one analyses the evolution of regional FDI, inward and outward FDI stock in the EU as well as in North-America, it appears that intra-EU FDI has been intensified much more than FDI within the NAFTA region in the period between 2004 and 2012. Figure 5 and Figure 7 show these trends taking into consideration inward FDI stock in new member states in the former and US outward FDI stock in Canada and Mexico in the latter.³

² After five years of enlargement, for example, the 2009 Commission report showed empirically how the old member states benefitted (via an extra growth impetus) of the East-West intra-EU trade and investment nexus. See European Economy 2009/1, Graphs II.2.6 and II.2.7, p. 39.

³ The different choice of outward stock (for intra-NAFTA FDI) and inward stock (for intra-EU FDI) has been driven by data availability. In fact, as regards intra-EU FDI, information on outward stock is not available at the EU level and thus data on source of FDI inward stock in new MS have been used to compute overall intra-EU FDI evolution. On the other hand, data on the source of inward stock FDI for Mexico are available only for a few years and thus data on US FDI outward stock by country of destination have been used to analyse the intra-NAFTA FDI evolution.

Figure 5. Weight of old member states in overall inward FDI stock in new member states (\$ bn)

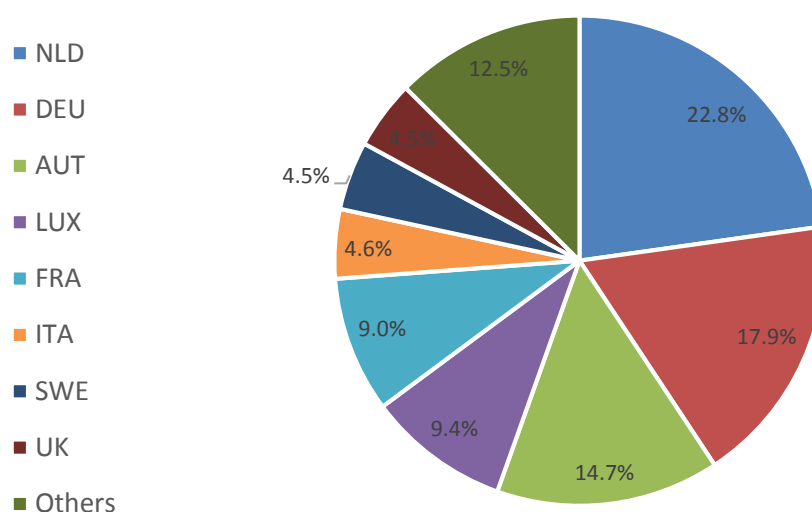


Note: Old member states group includes NLD, DEU, AUT, LUX, FRA, ITA, SWE, UK, ESP, BEL, GRC, DKN, FIN, PRT and IRL; new member states group includes BGR, CYP, CZE, EST, HRV, HUN, LTU, LTV, POL, ROU, SVK and SVN.

Source: Authors' own elaboration based on UNCTAD FDI/TNC database.

Analysing intra-EU FDI first, one observes a significant increase in inward FDI stock in new EU member states during the three-year period just after the 2004 enlargement. The second, and more significant trend emerging is that overall inward FDI stock in new member states has grown since 2007, both considering the total inward stock (i.e. WLD) as well as inward stock from the EU28 as a whole. In fact, the two lines showing instock from EU28 and old MS have started to significantly diverge in 2007, meaning that also intra-FDI between new member states has increased after the EU enlargement. Among the old EU countries, the Netherlands, Germany and Austria are the three first sources of inward FDI stock in new member states in 2012, holding a share of 22.8% (i.e. \$134.2 billion), 17.9% (i.e. \$105.7 billion) and 14.7% (\$86.9 billion), respectively (Figure 6).

Figure 6. Distribution of inward FDI stock in new member states by old member states, 2012 (%).

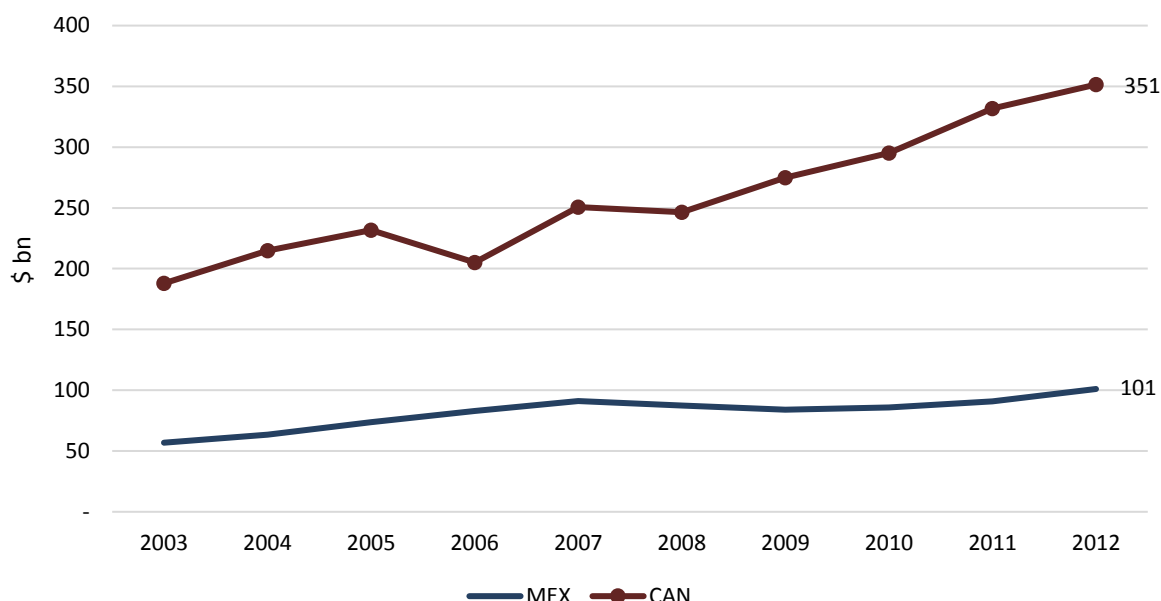


Note: Old member states group includes NLD, DEU, AUT, LUX, FRA, ITA, SWE, UK, ESP, BEL, GRC, DKN, FIN, PRT and IRL; New member states group includes BGR, CYP, CZE, EST, HRV, HUN, LTU, LTV, POL, ROU, SVK and SVN.

Source: Authors' own elaboration based on UNCTAD FDI/TNC database.

The US outward FDI stock of \$101 billion in Mexico in 2012 remains very far below the intra-EU inward FDI stock in new member states of \$590 billion in 2012. Moreover, since the full implementation of NAFTA on January 1st 2008, the US outward FDI stock in Mexico has remained flat. On the other hand, the US outward FDI stock towards Canada had begun to steeply grow exactly in 2008, moving from \$246 billion in 2008 to \$351 billion in 2012. In sum, the US FDI in North American 'regional globalisation' has been directed much more towards Canada (i.e. similar income economy) than Mexico (i.e. lower income economy).

Figure 7. Evolution of US FDI outstock in Canada and Mexico (\$ bn)



Source: UNCTAD FDI/TNC database.

1.3 Offshoring and job creation

One of the major concerns for American and European workers relates to employment in manufacturing. Are American and European low-to-medium skilled workers the losers of the globalisation game? The famous Freeman (1995) article, “Are your wages set in Beijing?”, has remained at the heart of the debate on the impact of globalisation for two decades. In 1995, Freeman showed that low-skilled male workers⁴ in the US suffered from a real hourly wage decline between 1979 and 1993 of no less than 20%. Lawrence (2014) estimates an involuntary displacement of 97,000 US manufacturing workers per year between 2000 and 2007 due to very competitive Chinese trade.⁵ Autor (2010) demonstrates the emergence in the US of job polarisation with the expansion of international trade. Demand for both low-skilled and high-skilled workers has been increasing, while demand for middle-skilled workers has followed a declining trend since the late 1980s. Goos et al. (2014) emphasise the existence of a similar phenomenon in Europe.⁶

⁴ Low-skilled workers are defined in Freeman’s article as workers with up to 12 years of schooling.

⁵ Nonetheless, the author points out that these figures represented less than one-fifth of involuntary job losses in overall US manufacturing.

⁶ Note, however, that in Brenton & Pelkmans (1999), the Freeman thesis of the suppression of real wages of low-skilled US workers was not confirmed for Europe. On the contrary, a long-term upward trend of real wages was found for all EU countries analysed. However, the risk of unemployment was comparatively higher in the EU.

Since directly measuring offshoring is a complex task that falls outside of the scope of this paper, this section focuses on EU and US FDI vis-à-vis the BRICS (Brazil, Russia, India, China and South Africa), as well as on domestic employment embodied in foreign final demand.

1.3.1 FDI in China and other BRICS

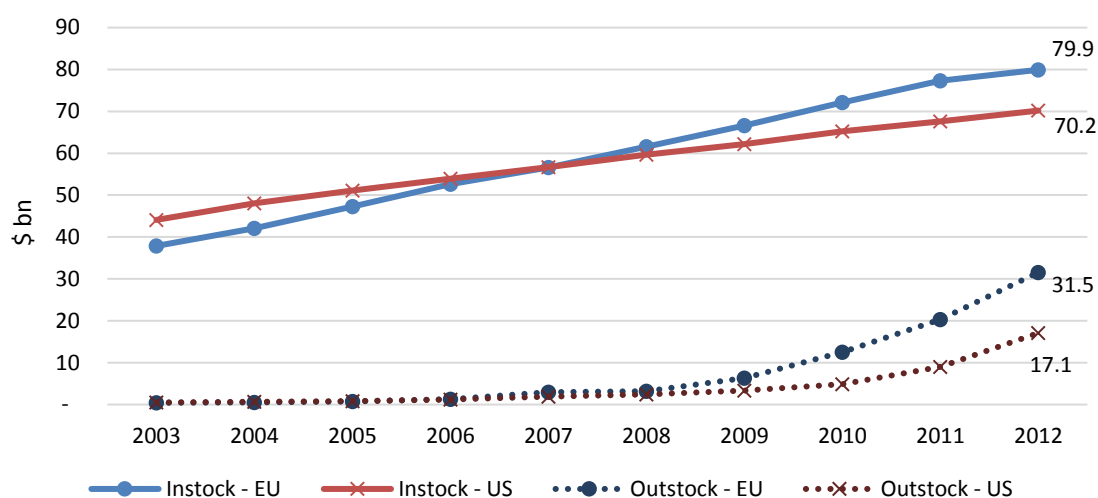
It is important to see how the EU and the US are connected with emerging economies, such as the BRICS, in terms of FDI. As Figure 8 shows, a significant change in the European and US FDI positions with respect to China took place in 2008. As far as Chinese inward FDI stock is concerned, the EU instock had continuously grown and surpassed the US instock in 2008. On the outward side, China had begun to invest in both foreign economies in 2007-08; yet, Chinese outward FDI stock in the EU had increased at a higher rate than Chinese outward FDI stock in the US in the four-year period 2008-2012. Thus, it would seem that the economic interdependence between China and the EU is more developed than that between the US and China, and there are signs that this has further intensified since. Indeed, at the end of 2015, European outward FDI stock to China amounted to €168.4 billion (about \$186.8 billion⁷) according to Eurostat, while US outward FDI stock to China accounted for less than half (\$75 billion) according to the Chinese Ministry of Commerce (MOFCOM).⁸ Chinese outward FDI stock to the EU at the end of 2015 amounted to €34.9 billion (or \$38.7 billion), while Chinese outward FDI stock to the US accounted for \$41 billion according to MOFCOM. However, this latter value is contested. The Bureau of Economic Analysis (BEA) of the US Department of Commerce reports a much lower value than MOFCOM of Chinese outward FDI stock to the US. According to the BEA, Chinese outward FDI stock to the US at the end of 2015 amounted to \$20.8 billion.⁹

⁷ All EU values of outward and inward FDI stock have been converted into US dollars using average yearly exchange rates from the ECB.

⁸ According to the US Bureau of Economic Analysis (BEA), US outward FDI stock to China was slightly smaller than the value estimated by MOFCOM and represented \$70 billion in 2015. That would mean that, after 2012 (Figure 8), US FDI stock in China has remained constant. MOFCOM reports utilise FDI data that capture actual foreign funds invested in FDI projects. On the other hand, the BEA computes FDI based on the BOP (balance of payments) methodology.

⁹ Once again, the divergence between BEA and MOFCOM values arises from differences in methodologies: MOFCOM does not, unlike the BEA, compute FDI values based on international BOP standards.

Figure 8. Evolution of Chinese inward and outward FDI stocks, EU and US (\$ bn)



Source: UNCTAD FDI/TNC database, based on data from the Ministry of Commerce (MOFCOM) of China.

Considering also the other BRICS, once again EU FDI stocks exceed by far those from the US (see Table 1). Only in the case of China, the picture appeared to be more balanced between the EU and US (that is, in 2012, and only when using UNCTAD data; not at all for 2015; see the discussion above). In fact, besides Russia for geographical, energy and political reasons, the marked differences between inward FDI stock in BRICS from the EU and those from the US are quite astonishing: the inward FDI stock from the EU in Brazil is four times the one from the US in 2012, two and a half times in India, and even ten times in South Africa. This leaves little doubt, once again, that the EU is a much more powerful globaliser than the US.

Table 1. BRICS inward FDI stock from the EU and US in 2012 (\$ bn)

	EU	US
INDIA	84.0	32.6
RUSSIA	345.4	2.9
SOUTH AFRICA	124.3	11.7
BRAZIL	464.8	113.4
CHINA	79.9	70.2
TOT	1,098.4	230.8

Source: UNCTAD FDI/TNC database, based on data from: i) the Reserve Bank of India, ii) the Bank of Russia, iii) the South Africa Reserve Bank, iv) the Banco Central do Brasil and v) the Ministry of Commerce (MOFCOM) for China.

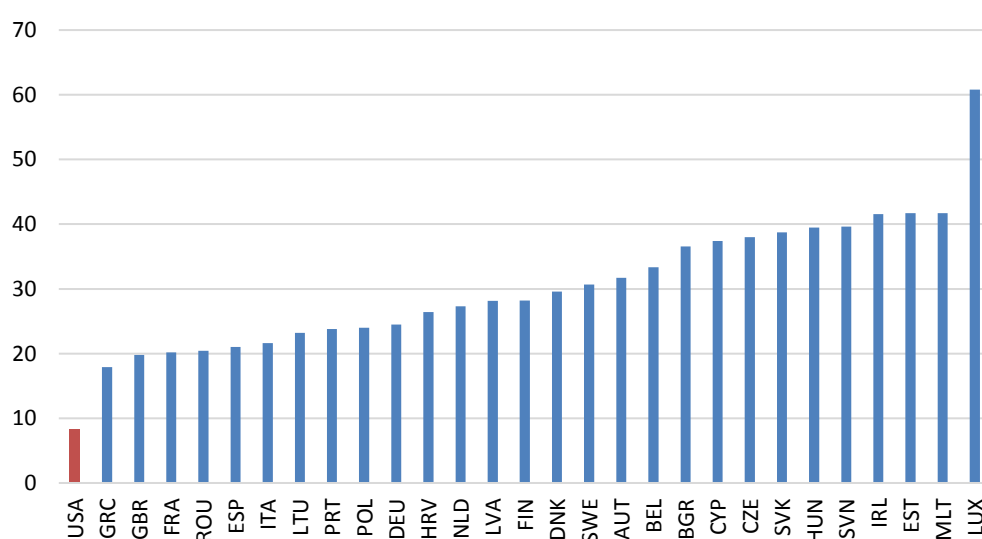
1.3.2 Domestic employment embodied in foreign final demand

It is well known that globalisation, whether regional or worldwide, has intensified with the building of value chains, often controlled by firms from OECD countries where (most of) the

final demand used to be located. Nowadays, the diffusion of final demand reflects much more clearly the rising prosperity of East Asia and some other countries as well. For developed economies, it is critical that their firms are capable of capturing the high value-added elements of the value chain in order to sustain the level of productivity and prosperity achieved so far. A simplified but meaningful way of studying this issue is to examine the domestic value added in final demand of goods of third countries. As Figure 3 and Figure 4 show, EU domestic value-added embodied in worldwide final demand and in Chinese final demand exceeds the comparable US measure, and also grows faster than that of the US in the case of China. Here we focus on employment shares (jobs). The US has the lowest share of domestic employment embodied in foreign final demand when comparing with all 28 EU countries (Figure 9). Although the share of domestic employment embodied in foreign final demand has risen by 21% in the US from 1995 to 2011, it remains below that of any EU member state. Central and Eastern European countries (CEECs) have the highest shares of domestic jobs embodied in foreign final demand, highlighting once again the importance of globalisation for these countries. However, Figure 9 for the EU includes intra-EU trade. As a result, the large share of domestic jobs embodied in final demand of CEECs may, in part, rely on final demand of other EU member states. In this case, this result would emphasise regional globalisation of these countries, rather than globalisation outside the EU.

Finally, although Western European countries such as France and Germany have a lower share of their domestic employment embodied in foreign final demand than CEECs, their reliance on foreign demand for jobs has been increasing from 1995 to 2011 by 26% and 67%, respectively. This trend suggests that those countries will find it in their interest to sustain globalisation as a strategy to facilitate foreign final demand to create new jobs. Going against globalisation would have adverse effects on jobs.

Figure 9. Share of domestic employment embodied in foreign final demand (average 1995-2011) (%)



Source: [OECD](#) Inter-Country Input-Output (ICIO) database.

Against this background, offshoring (FDI) does not appear as a major threat to EU employment. On the contrary, globalisation in FDI and trade may be a source of job creation in the EU.

2. Globalisation, adjustment and social insecurity of workers

2.1 Trade adjustment assistance

In the past, the basic idea was simple: trade openness on the whole is beneficial, generating gains in economic welfare and jobs, but there will be some losers who cannot easily adjust on their own, and they should be helped by special funding and policies (e.g. re-skilling). As numerous studies have shown, for trade openness (and often, most FDI as well) the expected gains tend to greatly exceed the losses for society, and that also goes for jobs. Governments should ensure that trade adjustment assistance for the losers is available and effective. This is a narrow approach to adjustment but it can nonetheless be valuable. The US has had various forms of trade adjustment assistance (TAA) over time as well as a Dislocated Workers Programme. Robert Lawrence (2014) shows that these programmes have been, in his words, “woefully inadequate” and actually served only a small share of the dislocated workers supposedly having lost their jobs due to trade exposure. Also, the sums spent on these workers were low by any standard. Moreover, TAA workers enjoyed unemployment insurance but only on the condition that they focus on training and hence not be active in the labour market. Proposals (under Obama) to make support comprehensive would include four components: income support, training, re-employment services and wage loss insurance (which Lawrence regards as much too low). Such proposals come close to the European notion of combining unemployment benefits, active labour market policies and the welfare state (as a security for workers and their families). The great drawback of any TAA is that it is both very hard but also arbitrary to single out workers who have lost their job due to exposure to competitive imports. There are many other reasons for job losses through no fault of the worker, and it is not sensible to argue that those other workers have somehow less hardship or less need for retraining, etc.

The importance of domestic policies to mitigate trade adjustment costs has been strongly emphasised in the recent study “Making Trade an Engine of Growth for All” (March 2017), carried out jointly by the IMF, the World Bank and the WTO. They stress that impacts of trade policy changes differ from sector to sector, regions and type of workers and that labour policies should be implemented accordingly. Moreover, the report shows¹⁰ public expenditure (as a percent of GDP) of 31 countries (20 of which are EU MS) in terms of both *active* and *passive* policies.¹¹ The first 11 countries in terms of public expenditure for *active* labour programmes are all EU member states, with Denmark, Sweden and Finland occupying the first three places.

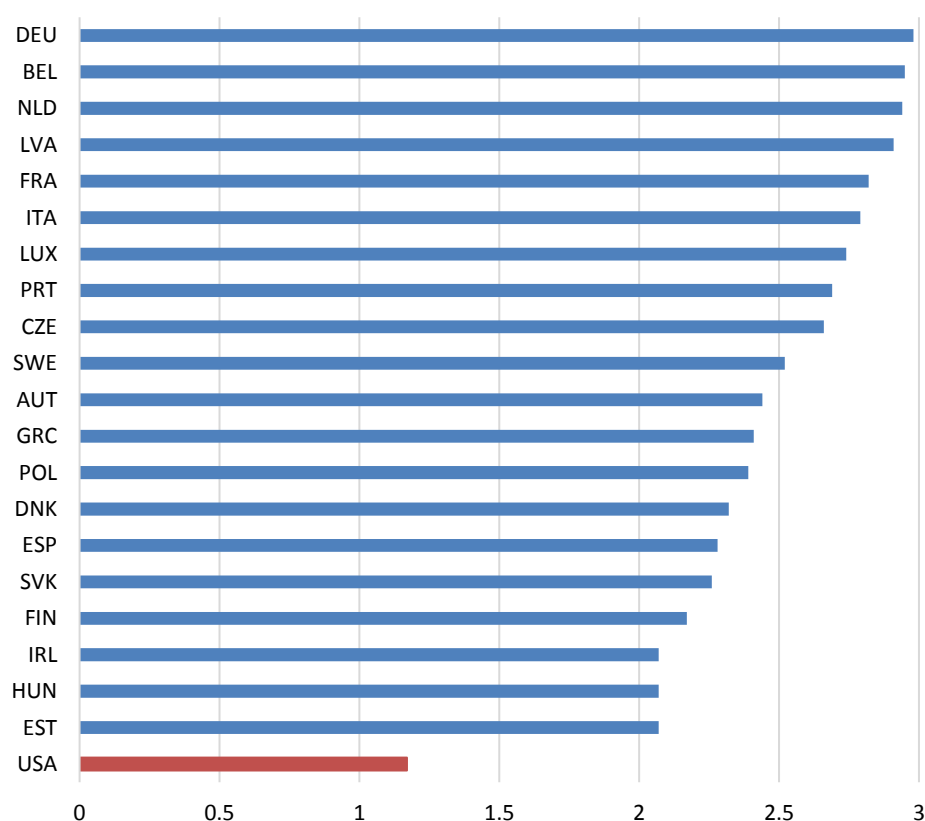
¹⁰ See p. 30, Figure 12 in IMF, World Bank and WTO (2017).

¹¹ *Active* labour policies are defined as training, public employment services, employment incentives, direct job creation, sheltered and supported employment and rehabilitation and start-up incentives. *Passive* labour policy, instead, includes out-of-work income maintenance and support as well as early retirement.

The US places third-to-last and fourth-to-last in *active* and *passive policies* rankings, respectively.

Another important element to take into consideration when looking at the impact of trade on unemployment and consequent job reallocation is the level of employment protection that employees enjoy. It lowers the risk of lay-offs in the short run for those having unlimited contracts. Figure 10 shows the index of strictness of employment protection (EPL index) in several EU member states and the US for 2013. The index captures the overall strictness of regulation of collective dismissals as the sum of costs an employer faces for individual dismissals and any additional cost of collective dismissals. The index goes from 0 (very loose) to 5 (very strict). Values for the index in all EU countries are higher than two and almost reach three for countries such as Germany, Belgium and the Netherlands. In the US this index has a value of 1.17. Moreover, among the 71 countries analysed by the OECD, the US occupies rank 69, just behind countries such as El Salvador, Saudi Arabia and Nicaragua.

Figure 10. Index of strictness of employment protection – individual and collective dismissals (regular contracts), 2013



Definition: The overall strictness of regulation of collective dismissals is the sum of costs for individual dismissals and any additional cost of collective dismissals.

0 = very loose, 5 = very strict.

Source: OECD indicators of Employment Protection.

EPL has drawbacks as well. In Europe, it is often regarded as a hallmark of rigid labour markets when the index approaches or goes beyond three. But studies have demonstrated that the net benefits of radically lower EPL indexes are small in terms of economic welfare and employment. Indeed, EPL reduces the speed of job losses in import-competing sectors – a short-run protection against the risk of job losses for workers with solid contracts – but it also renders employers in expanding sectors less willing to hire. Some argue that, with low indexes of EPL, the chances of getting hired by growing sectors increase which reduces the risk of not finding a job after having been laid off. In Europe, however, there is (often rightly) a great fear that the acceptance of such new jobs would only happen at far lower wages. Therefore, EPL has to be considered in the context of a wider institutional framework of social policies, including the welfare state.

In the EU, TAA has been mimicked (poorly) by a tiny European Globalisation Fund. Whereas in the typical European welfare state (including unemployment benefits), the reason of a job loss is irrelevant (which, compared to TAA, significantly lowers social insecurity), in the EGF the support depends on job losses due to ‘globalisation’ (usually, a closure of a plant due to off-shoring, a clear case).

Box 1. Highlights on the European Globalisation Adjustment Fund (EGF)

The European Globalisation Adjustment Fund (EGF) was first introduced in 2006 with the aim to provide support to workers who lost their jobs as a results of trade liberalisation. Since 2009, however, the scope of the fund has been enlarged to also absorb jobs losses due to shocks both generated by ongoing economic crisis as well as those that may arise in the future (Regulation EU No 1309/2013). In principle, a member state can activate the fund upon condition that at least 500 people have lost their jobs within a set of company or in a sector within a region. Nonetheless, this threshold requirement of 500 job losses can be bypassed by appealing to the notions of “small labour markets” and “exceptional circumstances”.

It is important to stress the way in which the EGF helps people who lost their jobs due to trade liberalisation or shocks generated by economic crisis. The fund does not provide any further measure of social protection to these people, but rather provides them with the possibility to take part in training and it also funds other projects that include mentoring and coaching, mobility and relocation allowances, and microfinance.

Concerning the overall allocated budget to the EGF, the initial amount of €500 million per year has been decreased, in 2013, to €150 million per year for the six-year period 2014-2020 (see Council Conclusion, [EUCO 37/13](#), 8 February 2013; the annual budget is expressed in 2011 prices). Since its launch, the EGF has been activated 167 times for a total of 141,800 beneficiaries who received, on average, €4,180 each (overview of EGF applications up until 21 February 2017; source European Commission [EGF Data](#)).

Finally, looking at achieved results, the average re-employment rate achieved at the end of EGF assistance was about 49% (see mid-term and ex-post evaluations of the MFF 2007-2013). Nonetheless, the fund has not been used to the full extent. In fact, the average implementation rate was approximately 55%, leaving a consistent share of unused allocated funds (see [Ex-post evaluation of the EGF](#), European Commission, 2015).

Source: Rinaldi & Núñez Ferrer (2017).

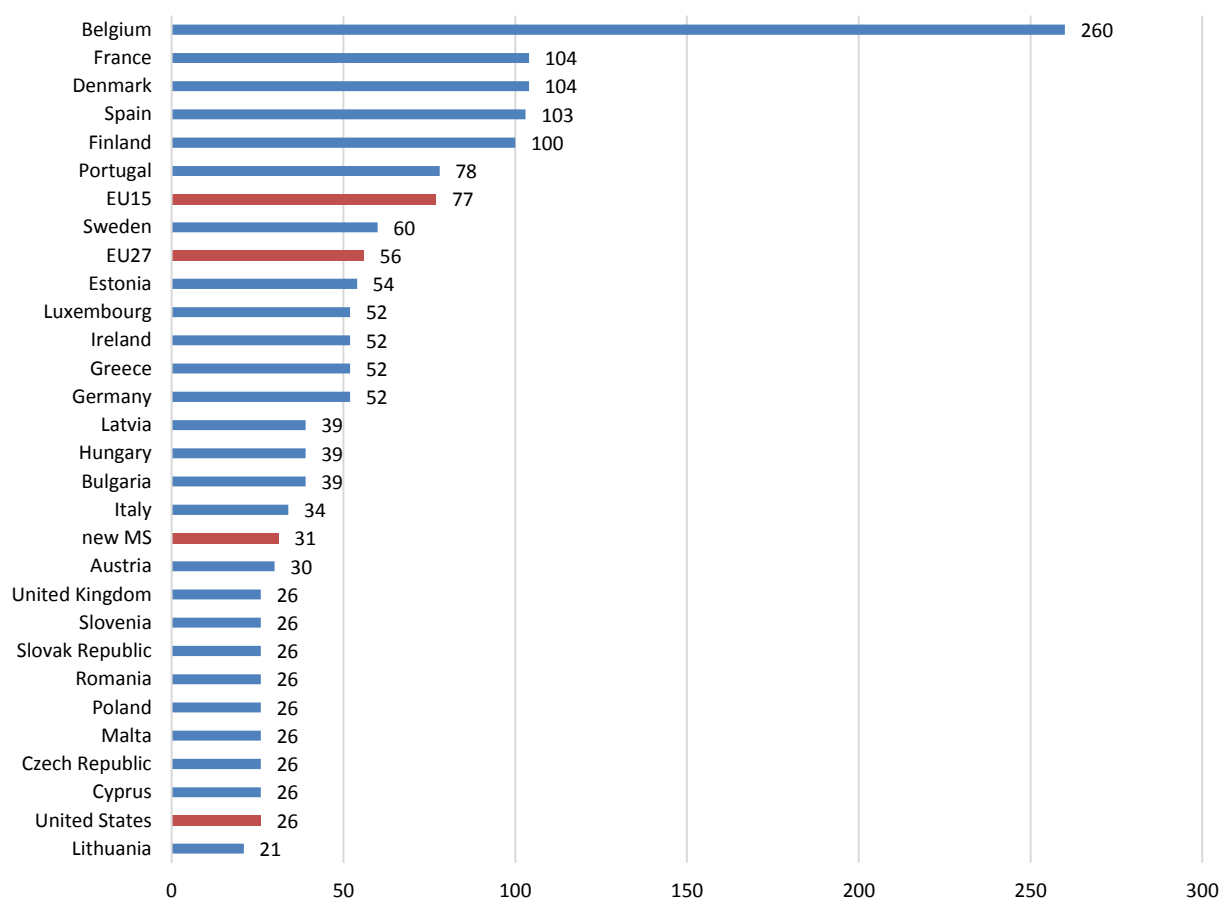
2.2 Unemployment, income loss and the welfare state

Unemployment protection and benefits deriving from a comprehensive welfare state are other keys variables in assessing the extent to which countries and workers can recover from labour disruption due also to international trade.

As concerns overall unemployment rates, the US is well-known – given its flexible labour markets but also its poor protection of workers – for rapid decreases in unemployment once a crisis is over. In Europe, this tends to be much slower. However, within the EU, countries differ enormously in terms of unemployment, also over time, and even more on e.g. youth unemployment. Although it goes without saying that a tight labour market will greatly reduce workers' anxiety about possible job losses due to globalisation, once the labour market is less tight, it seems almost impossible to generalise due to different rigidities, degrees of unionisation, wage gaps between unemployed and employed, etc.

Indeed, unemployment rates (except when extreme) by themselves say little about the capacity to absorb job losses and reallocate workers across and within economic sectors in a timely fashion. What is important to see, in fact, is the extent to which workers are protected when they find themselves unemployed, both in terms of time-coverage of unemployment benefits and the share of previous income received during unemployment. Figure 11 ranks EU countries and the US by the number of weeks people were covered by unemployment benefits in 2010. In the US, unemployment benefits are foreseen for a total of 26 weeks as is the case in several new member states (e.g. Poland, Malta and Czech Republic) as well as in the UK. The EU27 average, instead, registers a duration of 56 weeks, while the number of weeks increases up to 77 when only EU15 is considered.

Figure 11. Time-coverage of unemployment benefits in weeks, 2010



Note: No data available for Croatia; new member states group includes the EU enlargement of 2004 (10 countries) plus Bulgaria and Romania.

Source: Authors' own elaboration based on Social Policy Indicators (SPIN).

Table 2 reports some indicators that capture different degrees of benefits from the respective systems. All indicators shown are based on a one-earner couple, with two children as reference group.

The net replacement rate is defined as the share of the previous net income workers obtain when they are unemployed. As shown in Table 2, European workers obtain, on average, 68.3% of their previous net income from the second month following unemployment, in line with the OECD average (68.6%); the share is also quite high for workers in new member states. US workers receive, on average, 48.8% of their previous net income in the initial stage of unemployment. When one looks at long-term unemployment, shares clearly fall, but the trend is the same as the one for initial unemployment. In fact, EU citizens are still better off than US citizens, with an average net replacement rate (over a 5-year average) of 54.2% vs 34.9% for US citizens.

Finally, the minimum income benefits indicator shows the net income of a one earner couple with two children, out of work, receiving minimum income benefits only, as a percent of median income. Also in this case, EU citizens are, on average, better off than US citizens, with a difference of almost 15 percentage points (i.e. 38% vs 22.5%).

Table 2. Selective social security indicators, 2014

		EU27	EU15	New MS	OECD	United States
Benefits and generosity	Net replacement rate - Initial unemployment (% of previous net income)	68.3	72.8	62.5	68.6	48.8
	Net replacement rate - 5 year average (% of previous net income)	54.2	59.5	47.0	57.7	34.9
Income adequacy	Minimum income benefits (% of median income)	38.0	41.0	33.3	40.0	22.5

Note: Indicators computed for a one-earner couple, with two children; No data available for Cyprus across all indicators.

Source: Authors' own elaboration based on OECD, Tax-Benefit Models (2015).

3. Implication of globalisation for income distribution and inequality

Countries in the world economy differ a great deal in terms of income distribution (IMF, 2007). This has many reasons and some of them can be derived from underlying preferences. It is therefore by definition highly selective to single out globalisation as the 'culprit' for a degree of income inequality seen as adverse. What is possible, although far from easy, is to verify empirically whether or not globalisation has caused greater inequality.¹²

A first step to analyse changes in income distribution and inequality is to analyse the evolution of earnings of low-skilled workers. If one begins by considering earnings of the least-educated people in the US and the EU, US workers did not underperform compared to both the EU average as well as German, French, Dutch and Italian workers. In 2014, for instance, the median annual earnings of least educated employees in the US was €19,000 compared to €13,000 at EU level, €13,300 in Italy, €15,440 in Germany, €17,890 in France and €18,380 in the Netherlands.¹³ The trend has been more or less constant since 2005, with US median annual earning going below the French and Dutch ones in the period 2007-11.

¹² Inequality in income distribution. We ignore inequality in the distribution of wealth.

¹³ Please note that: i) US earnings have been converted into euro using average yearly exchange rates from the ECB; ii) educational attainment for the US is defined as "Less than a high school diploma", and for the EU it is defined as "Less than primary, primary and lower secondary education (levels 0-2); and iii) age interval is considered above 25 years old for the US and between 18-64 for the EU.

Nonetheless, this does not necessarily mean that income inequality has decreased, as one also has to look at the evolution of income of the best-earning part of society. Moreover, one can ask the question whether, in the lowest decile, those that do have jobs, would possibly be affected by globalisation. Apart from those on welfare or in subsistence agriculture, workers are likely to have the simplest jobs such as cleaners, bell boys, etc., and these are typically not affected by trade and investment. Actually, more openness to trade can help the people in the lowest shares of income distribution through lower prices in key products. The study “Making Trade an Engine of Growth for All” (March 2017)¹⁴ refers to a “pro-poor” bias caused by the benefits of lower prices and consumer choice that come with trade. Relative to a situation in which countries do not trade at all, trade (here, competitive imports) lowers prices in ways favouring poor consumers more than rich ones, as the former “spend relatively more on sectors that are more traded (e.g. food and beverages) and thus experience larger price drops upon opening to trade”.¹⁵ Moreover, the study also shows that this pro-poor bias is stronger in advanced economies because the sectors in which poor consumers spend relatively more usually are also those in which advanced economies are not specialised. They estimate that if trade would shut down, the bottom decile in the US would lose almost 70% in real income, while the top decile’s income would lose not even 10%. In Germany, the real income of the bottom decile would drop by 56%, while that of the top decile would shrink by a mere 21%.¹⁶

Hence, in order to better investigate the impact of globalisation on income inequality, we pursue the analysis using higher deciles or quintiles, which are far more likely to comprise blue collar and other semi-skilled workers, possibly affected by globalisation.

When compared with European countries, it is clear that income inequality is greater in the US than in Europe. Figure 12 and Figure 13 plot the ratio of the income share held by the highest vs the lowest 20% (Y axis) of income earners, together with trade openness (based on extra-EU trade for EU countries) (X axis), considering Central and Eastern European countries in Figure 12 and Northern and Southern European countries in Figure 13.¹⁷

Even though both figures provide only a very basic analysis, some trends between the two variables emerge. The first trend is that countries more open to trade tend to have a lower level of income inequality (e.g. Czech Republic, Slovakia and Slovenia in Figure 12). Second, most of the countries having increased their trade openness in the period between 2004 and 2012 (2013 for the US) saw income inequality decrease. This second trend is especially visible in countries such as Latvia, Poland and Estonia for the Central and Eastern European region (Figure 12), and in the Netherlands, Belgium and the UK for the North-Western European region (Figure 13), but not for the US and Southern EU countries.

¹⁴ See also Hufbauer & Lu (2017).

¹⁵ See p. 22 of IMF, World Bank and WTO (2017).

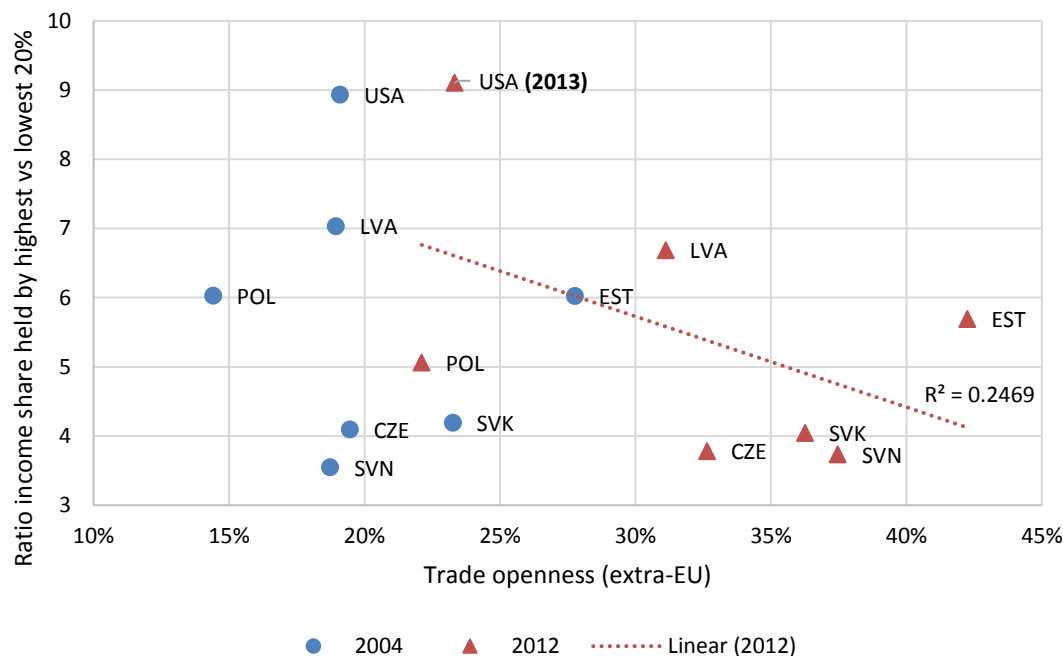
¹⁶ See Figure 11, p. 22, Ibid.

¹⁷ See Annex, Figure A 1 and Figure A 2 for the ratio between first and last 10%.

This decreasing trend of income inequality going hand-in-hand with an increase in trade openness is in line with previous findings. The recent study “Making Trade an Engine of Growth for All” (March 2017) by the IMF, the World Bank and the WTO makes the observation: “patterns suggest that openness to trade promotes poverty reduction by accelerating growth in average income, [...] but that the extent to which trade has the potential to reduce poverty is fundamentally dependent on the institutional environment”.¹⁸ They estimated that the income growth of the bottom 20% increases in line with average income growth.

The role of the institutional environment stressed in the study might explain why the ratio shown in Figure 13 has increased between 2004 and 2012 (2013 for the US) both in the US and in countries such as Italy and Spain. Whereas the increase in income inequality in Italy and Spain is present using both the ratio between first and last quintile (Figure 13) and between first and last decile, the same is not true for the US.¹⁹ Indeed, using the ratio between the highest vs the lowest 10%, income inequality in the US (slightly) decreases due to both a decrease of the income share held by the highest 10% and an increase in the share held by the lowest 10%. When, instead, the highest and lowest 20% are considered (Figure 13), the ratio has increased between 2004 and 2013 in the US as the income share of the highest 20% has increased while that of the lowest 20% has decreased.

Figure 12. Income inequality and trade openness (extra-EU trade) first vs last quintile, Central and Eastern Europe

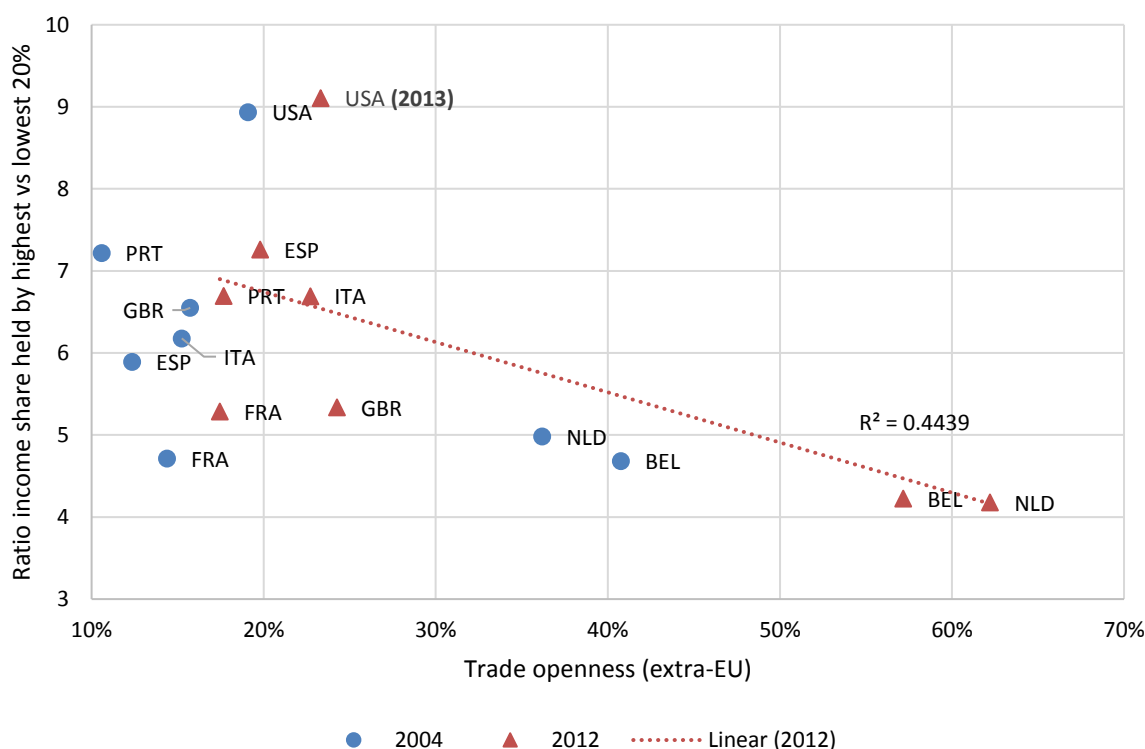


Source: Authors' own elaboration based on World Development Indicators (WB) and COMEXT.

¹⁸ See Annex A, pp 42 and 43 of IMF, World Bank and WTO (2017).

¹⁹ See Annex, Figure A 1 and Figure A 2 for the ratio between first and last 10%.

Figure 13. Income inequality and trade openness (extra-EU trade) first vs last quintile, Northern and Southern Europe

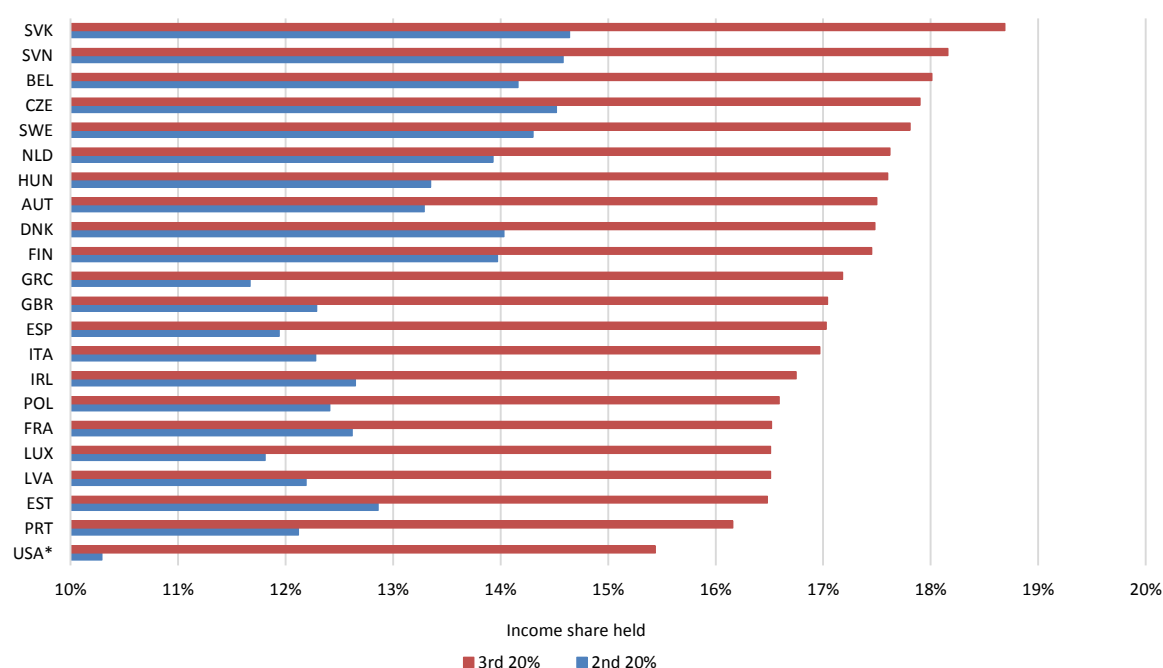


Source: Authors' own elaboration based on World Development Indicators (WB) and COMEXT.

A further extension of changes in income distribution is shown in Figure 14, in which the income shares of both the second and third quintiles are plotted for 21 EU member states and the US (once again, data for the US refer to 2013 instead of 2012 due to lack of data). Observe how well the second and third quintiles perform in the income distribution. This is important as it is within these shares of population where most of the blue-collar and other semi-skilled workers hit by international competition (especially from China) should be located. Concerning the income share held by the second 20% of the population, Nordic and Eastern European countries register the highest shares (e.g. Slovak Republic, Slovenia, Sweden, Denmark and Finland). The same is true for the third 20% of the population (thus richer than the second 20%). It is nevertheless interesting to see that in Southern European countries as well as in the UK, the third 20% is proportionally better off than the second 20%. Taking Greece as example, the country occupies a place in the middle of the list when countries are ranked by the income share held by the third 20% (as shown in Figure 14), but it would fall to the second-worst position of the ranking if countries were ordered by the share held by the second 20%. Looking at the US, the country is once again the worst performing compared to EU member states, ranked lowest both in terms of income shares held by the second and the third 20%.

It is important to stress, however, that even if we cannot argue that an increase in trade openness directly lowers income inequality, it is also true that the opposite trend did not happen for the majority of countries analysed here. Moreover, those countries that increased trade openness the most between 2004 and 2012 (e.g. the Netherlands, Belgium and Central and Eastern European countries) have all seen their inequality going down. Once again, increase in trade openness has been found to accelerate growth in average income, but redistribution of gains arising from this growth depends on the institutional environment of each country (IMF, World Bank and WTO, 2017).

Figure 14. Income share held by the 2nd and 3rd quintile, 2012



* Data used for the USA refer to 2013; the x-axis begins at 10%.

Source: World Development Indicators (WB).

4. Conclusions

This CEPS Policy Insight has attempted to provide some empirical economic and social guidance behind the recent policy divergence on globalisation between the US and the EU. The EU strongly favours responsible globalisation and has maintained, if not intensified, its strategy of improving market access via a series of FTAs (especially, but not only, in East Asia), besides the ambitious pursuit of WTO plurilaterals. The EU also attempts to lead the global debate by vigorous pleas on economic openness in all kinds of international organisations. Although it has its complaints about China (e.g. on dumping and distortive subsidies, as well as market access and investment issues), it favours a route of gradual opening up via the CAI (Comprehensive Agreement on Investment), a broad range of dialogues and technical cooperation projects, a later option of a bilateral FTA with China and participation in the AIIB and Belt and Road (Hu &

Pelkmans, 2017). The stark contrast with the more confrontational approach by the US could hardly be ‘better’ expressed than in the slogan ‘America First’.

We show that the EU has a strong stake in globalisation and it is relatively successful (compared to US globalisation performance) when measured against some critical indicators. Focusing on goods trade (given the sensitivities about manufacturing), extra-EU exports are far higher than those of the US, the EU has an overall trade surplus and has not suffered from structural trade deficit anxieties (both in contrast to the US). And the bilateral trade-in-goods deficit with China is ‘only’ 30% of China’s goods export to the EU (compared to no less than 60% for the US), whilst its exports of goods to China far exceed those of the US as well. A US-EU comparison of Revealed Comparative Advantage indexes shows the EU has a more favourable RCA vis-à-vis the world as well as vis-à-vis China than the US. Furthermore, when it comes to domestic value-added embodied in foreign demand (an indicator for export-induced growth and jobs), the EU performs much better vis-à-vis the world and bilaterally with China, than the US.

Part of what has been termed “globalisation” is actually “regional”, with the exploitation of very different comparative advantages in groups combining less developed and developed economies. For the US regional globalisation occurs in NAFTA (with Mexico) and for the EU inside the EU with Central and Eastern European countries. Both the intensity and mutual benefit of regional globalisation of the EU-28 compare quite favourably with that for the US in NAFTA. Not only is the FDI stock of the ‘old’ EU-15 in Central Europe a multiple of what the US has invested in Mexico, the trend in Europe is gradual intensification of this regional globalisation, whereas the FDI stock of the US in Mexico has been flat for the last decade. Economic literature has demonstrated that the EU-15 FDI in Central Europe, and the two-way trade induced by it, generates an extra growth effect in the EU-15, which mitigates or pre-emptly sentiments of a ‘sucking sound’. Again, in the US there is a major debate on precisely the point of a significant export of jobs. It is actually striking to compare the FDI performance of the EU and the US in the BRICS where the EU stocks are a multiple of the US stocks. But a comparison of domestic employment embodied in foreign demand underlines that the US scores far less than any one of the EU member states. Rather than a threat to EU jobs, globalisation in trade and FDI is, on the whole, a source of job creation in the EU.

A major concern about globalisation already for two decades or more is that the temporary losers at home – who have to adjust sooner or later – incur major income losses, are saddled with a sense of insecurity and may find themselves jobless for extended periods of time. When (rightly) emphasizing overall economic gains and extra jobs from globalisation, one cannot and should not ignore or treat as a side issue the social security sentiments and actual losses of adjusting workers. We conduct a basic analysis of US trade adjustment assistance (TAA) and other forms of protecting adjusting workers. We find that TAA is heavily criticized for a host of reasons, and it also compares poorly to social protection in the EU, even when the latter differs between EU countries. Comparing employment protection indexes yields that they are in a range between 2 and 3 (the latter being regarded as fairly rigid for labour markets) for EU countries whilst the US is at 1.17, one of the lowest among OECD and many emerging

economies. Focusing on unemployment benefits, in terms of time coverage the US (and some EU countries) maintain 26 weeks, with EU countries guaranteeing on average 56 weeks and the EU-15 on average 77 weeks. In terms of income loss, the net replacement rate (of income) is around 68% compared to the US with 49% (with 54% versus 35% for longer periods on average). Finally, the minimum income benefit for a couple with two children without any other income is also higher in Europe (38%) than in the US (22%).

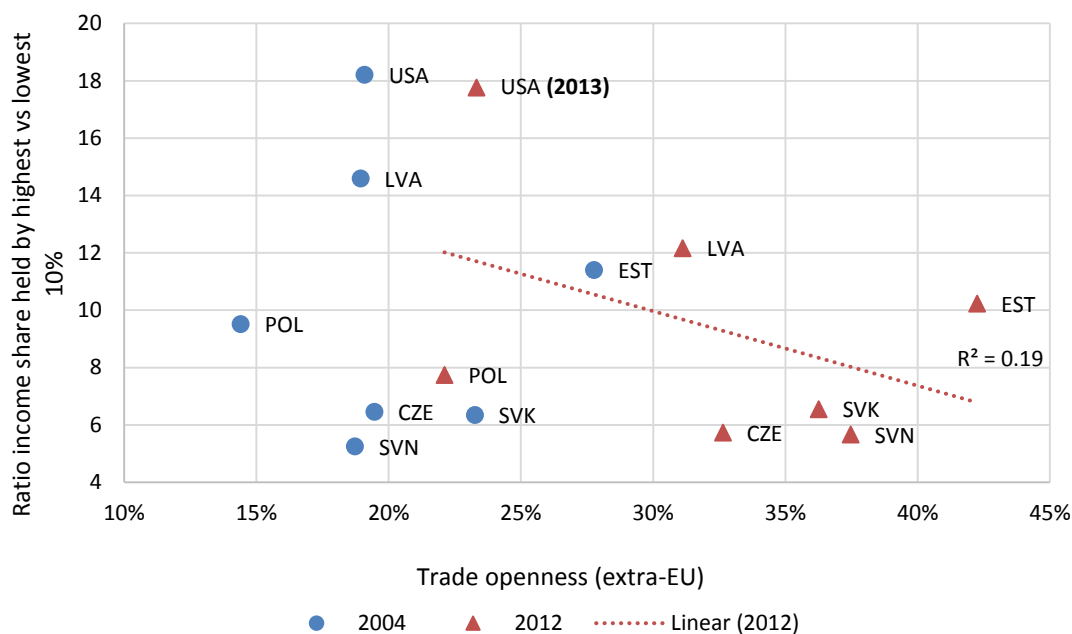
Finally, we studied the relationship between globalisation and (income) inequality. The difficulty here is to locate where the adjusting workers are found in the deciles or quintiles of income earnings in a country. The lowest decile is unlikely to comprise many adjusting workers as these individuals may be on welfare, or in subsistence agriculture or have very simple service jobs (e.g. cleaners) that are not vulnerable to globalisation. In any event, the poorest decile benefits significantly from globalisation via another channel, namely, price decreases in consumer goods: for the US poorest decile, this is estimated to amount to no less than nearly 70% (admittedly, compared to no trade at all) of their real income (and the top decile only 10%); for Germany these benefits would be 56% and 21%, respectively. In a correlation exercise, we find that i) countries more open to trade tend to have a lower level of income inequality, and ii) most of the countries having increased openness recently experienced a decrease in income inequality. In the exercise for higher quintiles (2nd and 3rd 20%), the pattern is not uniform but what can be said is that greater openness has almost never been accompanied by more inequality.

There is no doubt that globalisation is a natural trend reflecting the emergence of a true world economy where many more, if not all, countries genuinely participate. There is also no doubt that this long-term process is not entirely smooth and that China has not yet achieved fully-fledged participation on a basis of reciprocity.²⁰ Nevertheless, a comparison of the EU with the US performance in today's globalisation reveals that the former is far better for domestic growth and jobs. And it also shows that a given (problematic) level of market access in China for both US and EU companies can nonetheless yield quite distinct benefits. Finally, globalisation has to be legitimate in that the overall gain ought to be used to compensate or at least protect as much as possible the temporary losers, and the EU is, on the whole, assuming a greater responsibility for adjusting workers than the US.

²⁰ As shown in a very detailed study of a possible free trade area between the EU and China by Pelkmans, HU, Mustilli, Di Salvo, Francois, Bekkers, Manchin and Tomberger (2016).

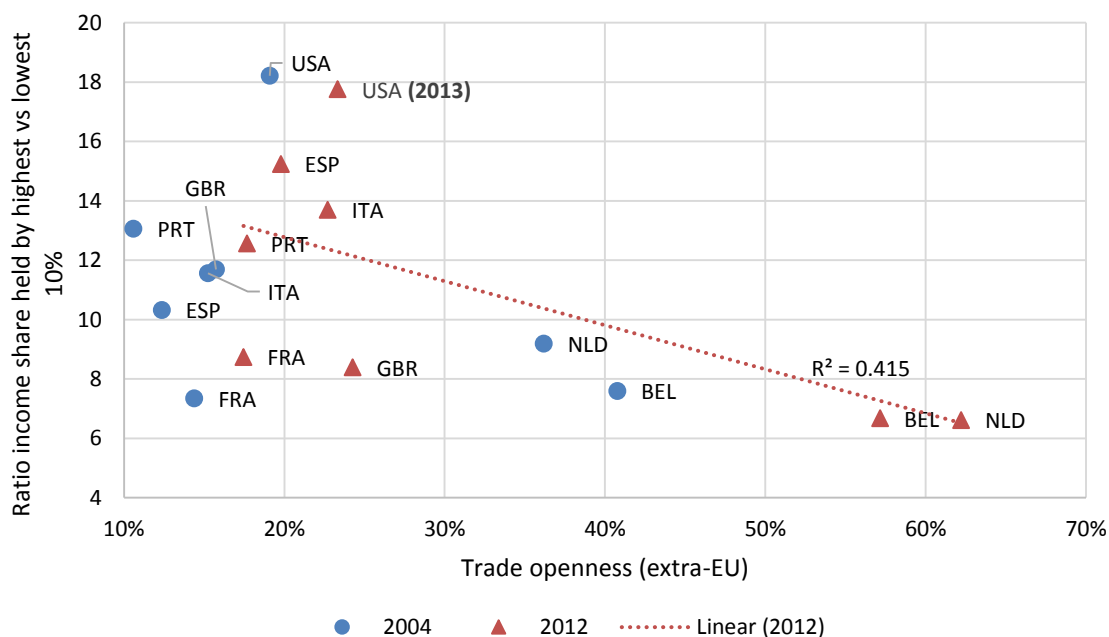
Annex

Figure A 1. Income inequality and trade openness (extra-EU trade) first vs last decile, Central and Eastern Europe



Source: Authors' own elaboration based on World Development Indicators (WB) and COMEXT.

Figure A 2. Income inequality and trade openness (extra-EU trade) first vs last decile, Northern and Southern Europe



Source: Authors' own elaboration based on World Development Indicators (WB) and COMEXT.

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